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CHARLES ELMORE CR
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IN THE

Supreme Court of the United States

October Term, 1936.

Nos. 186 - 187

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ALBERT FRIED

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BENJAMIN EINHORN

On petition for writs of certiorari to the United States Circuit Court of Appeals for the Second Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

JOHN J. CURTIN,
Counsel for Respondents.

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Opinions Below

The opinion of the United States Board of Tax Appeals (R. 34-46) is reported in 31 B. T. A. 130. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 59) is reported in 83 Fed. (2nd) 193.

Jurisdiction

The judgments of the Circuit Court of Appeals were entered April 13, 1936. The cases were consolidated and involve the same question and the same facts. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented

Whether the partnership of Albert Fried & Co. was a dealer in securities in which it specialized and as such entitled to inventory such securities at market value in determining net income.

Statute and Regulations Involved

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

* * * * * * * *

(c) *Inventories*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

* * * * * * * *

Treasury Regulations 74:

ART. 105. *Inventories by dealers in securities*—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either

(a) At cost;
(b) At cost or market, whichever is lower; or
(c) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the methods employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years unless another be authorized by the Commissioner. For the purpose of this rule, a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

Statement

All of the facts were stipulated (R. 27-31).

The respondents are members of the partnership firm of Albert Fried & Co. Each of the partners owned a membership on the New York Stock Exchange, where floor space was leased for the transaction of the firm's business. The firm also maintained an office in New York City (R. 28).

The firm was a specialist in thirteen stocks traded in on the exchange (R. 28). It always had on hand the securities in which it specialized, and during the fiscal year ending January 31, 1931, the year involved here, its supply ranged from 10,300 shares at the end of one month to 62,300 shares at the end of another (R. 29-30).

"The firm held itself out generally and was known to all of the members of the exchange as the specialist in these thirteen stocks, and it was regularly and consistently engaged in the purchase and resale of such securities" (R. 29). (Italics ours.)

Its customers were other members of the Exchange acting for themselves or as brokers, and during the taxable year the firm sold its specialties to 431 of these members and the sales ran from a minimum of 100 shares to a maximum of 5,700 shares. All the stocks which the firm bought and sold were actually received and delivered by it (R. 30-31).

Ever since its inception the firm has regularly inventoried in its books of account its unsold securities on hand at market value, and in its income tax returns it has computed its net income on the same basis (R. 31).

The Government further stipulated that "Of the 126,200 shares of Air Reduction sold on the Exchange in one month, 59% was sold by the firm. Of a total of 328,700 shares of Northern Pacific sold on the Exchange in one month 45% represented shares sold by the firm" (R. 30).

The firm obviously did not acquire and own such large blocks of stock (R. 32) for speculation. The firm carried a preponderance of and was a dominant factor in the stocks in which it specialized.

The Government further stipulated that on numerous occasions the partnership purchased and sold the securities in which it specialized in order to maintain fair and equitable markets and as far as possible to prevent wide fluctuations in price on such securities (R. 31). Sales of the firm were not occasional but were regular, frequent and substantial in amount (R. 30).

There is no proof in the record that the purchases made by the firm in the stocks in which it specialized were for either investment or speculation and no such inference can be drawn, on the contrary the volume of business conducted by the firm and the position taken by the firm in the securities detailed in the stipulation of facts is convincing and establishes that the firm as a specialist in the thirteen securities enumerated *dealt* in and did not trade or speculate in such securities.

In determining the tax liabilities of the respondents for the year here in question, the Commissioner denied their contention that the firm was entitled to inventory stock as a dealer in securities, and accordingly asserted deficiencies against the respondents (R. 9, 11; 21, 23). The Board of Tax Appeals by a divided vote approved the Commissioner's action (R. 44) but the Circuit Court

of Appeals for the Second Circuit reversed the Board, remanding the cases for further proceedings in accordance with its opinion (R. 59).

Argument

The sole ground for the application for the writs of certiorari is the alleged conflict of the decisions of the Circuit Court in *Commissioner* v. *Stevens,* 78 F. (2d) 713, which the present case expressly follows, and *Schafer* v. *Helvering,* 83 F. (2d) 317, decided by the Court of Appeals for the District of Columbia, in which latter case this Court granted writs of certiorari (Nos. 24, 25 and 26, October Term 1936).

The Court of Appeals for the District of Columbia in the Schafer case was unable to distinguish between the facts in that case and the Stevens case and *Commissioner* v. *Charavay* (C. C. A. Third Circuit 79 F. [2d] 406). The Government however opposed the certiorari in the Schafer case, taking the position that the Schafer case did not conflict with the Stevens and the Charavay cases, and in doing so emphatically and decisively showed the wide differences in the facts of both such cases. *The Government* in its brief opposing the application for the writ of certiorari in the Schafer case so clearly expresses the views of the taxpayers in the instant case that it is quoted at length:

> "The Stevens and Charavay cases were part of the same proceeding involving the brokerage firm of Stevens and Legg, and were considered by the Board of Tax Appeals sub nom. Estate of Harry E. R. Hall, 29 B. T. A. 1255. The Board's opinion in that case reveals that the firm of Stevens

and Legg was a 'specialist' on the New York Stock Exchange in some fourteen securities. As such, it held itself out as a dealer in those securities. At all times it carried a sufficient stock of them on hand to supply the demands of its customers, who numbered 101, and who made 268 separate purchases of its stocks during the taxable period. Its floor member occupied a regular post on the floor of the exchange, where he always stood ready to buy or sell. The firm's sales were large and to meet the demands it kept on hand a large supply of the stocks which it constantly replenished through purchases.

"This brief summary reveals the wide difference between the facts of that case and those of the present one. The purchases made by the Schafer firm were not to replenish a stock in trade, but were rather, as the Board found (R. 35), independent of the customers of the firm, and were made in expectation of a rise in the market price and for resale to anyone at a profit to the firms' account. The firm did not sell to and buy from brokers *as a merchant,* as did Stevens and Legg; it purchased and sold as a speculator. Moreover, in cases involving facts quite similar to the present ones both the Second and Third Circuit Courts of Appeal have recently denied the inventory privilege to speculators, with opinions which reveal their agreement with the principles laid down by the opinion in the instant case. Seeley v. Helvering, 77 F. (2d) 323 (C. C. A. 2d); Hammitt v. Commissioner, 79 F. (2d) 494 (C. C. A. 3d).

The Court of Appeals further found in the instant case that there was no material difference between the instant case and the Stevens case.

In the Stevens case, in the Charavay case, in *Vaughan v. Commissioner,* decided by the Second Circuit Court of Appeals August, 1936 (not yet reported) and in the instant case, the Court of Appeals found that the taxpayers were *specialists*, whereas in the Schafer case the Court found that the taxpayer was a *speculator.* In each case decided to date by the Circuit Courts a "specialist" was held to be a dealer and therefore entitled to inventory his securities in the computation of his tax return.

The Court of Appeals for the Second Circuit in the Vaughan case defined a specialist as follows:

> "A specialist is one who, having a position at a designated 'post' on the floor of the Exchange, maintains a book in which he enters all offers and bids for the stocks in which he specializes, thus indicating the 'market' for the stocks. The offers and bids are ordinarily made by other members of the Exchange. But the specialist is required to be ready at the demand of other brokers to quote the market price and to buy and sell at the closest fluctuations possible. Where the 'bid' and 'asked' prices furnished by the brokers coincide and the transaction is thereby effected, the specialist acts as a broker in the transaction. But where there is too wide a 'spread' between the 'bid' and 'asked' prices, in order to create a market, he either buys or sells the stock for his own account. Thus he becomes the owner of any stock acquired in this way * * *"

The Court further said:

> "We think that under the regulations Vaughan and the firm of Vaughan & Co. were 'dealers' in the

> five stocks in which they acted as specialists. As specialists they were required by the practice of the New York Stock Exchange to have on hand a supply of the stocks in which they dealt, so as to round out orders in cases where the bid and asked prices did not match, and to make deliveries where they were selling stocks to maintain a market."

We firmly believe that had Schafer established that he was a "specialist" the Court of Appeals of the District of Columbia would not have disagreed with the Second Circuit Court of Appeals. However, as Schafer was not a "specialist" and was found by the Court to be a "speculator" he was not entitled to inventory his securities, and therefore there is no conflict, upon analysis, between the Schafer case and the Stevens case or the instant case.

While the Court of Appeals of the District of Columbia in the Schafer case stated that the facts in the Stevens and Charavay cases were indistinguishable from the Schafer case nevertheless in its opinion the Court shows the distinguishable elements in these cases:

> "* * * Petitioners have an established place of business and held themselves out to their customers as authorized and qualified to buy or sell for them, as broker, shares of stocks and bonds; but there is *not a word of evidence that they likewise hold themselves out as having on hand securities for sale on their account, or that they personally or through salesmen carry on the business of selling their own securities to their own customers.*" (Italics ours.)

Further, the Court said:

> "* * * The element of resale *to customers—i. e.*, people who regularly or repeatedly deal with them—necessitates both possession of the thing to be sold and customers to sell it to. In the present case the last element is wholly lacking. Petitioners never had in mind disposing of their securities to their partnership's customers."

On the other hand, in the instant case the Government stipulated the following (R. 29-30):

> "10. The firm held itself out generally and was known to all of the members of the Exchange as the specialist in these thirteen stocks, and it was regularly and consistently engaged in the purchase and resale of such securities."
>
> "12. The firm always had on hand the securities in which it specialized. Schedule 1 attached herewith shows the number of shares of these stocks owned by the firm at the end of each month in the year under review. As shown in this schedule the shares carried ran from 10,300 shares at the end of one month to 62,300 at the end of another."

The foregoing facts it is contended by the taxpayers precludes the Government from now claiming that the cases are indistinguishable or that the decisions are in conflict, as the stipulation of facts overcomes the criticism pointed out by the Court in its opinion in the Schafer case and contains the very elements specifically stated by the Court to be lacking in the Schafer case to constitute the taxpayer a dealer in securities.

We therefore contend that the wide difference in the facts in such cases justifies different opinions, conclusions and determinations.

Conclusion

We submit that the decisions on the question involved are not in conflict and that the instant cases do not present a question which warrants review by this Court. The petition should be denied.

Respectfully submitted,

JOHN J. CURTIN,
Counsel for Respondents.